The 'China Price' is Rising

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Article:

In recent years the phrase "China Price" has generated fear and loathing among American manufacturers, who are often pressured by distributors and retailers to match the low prices of Chinese imports. Most consumers haven't heard of the China Price, but it's one of the reasons that retail inflation has been kept in check in this country.

But now the China Price is rising. A number of factors are changing both the nature of global trade and the face of Chinese manufacturing. While these factors are unlikely to suddenly reverse the trend of outsourcing to China, they may well slow it.

Rising fuel prices

The advent of containerized shipping lowered costs and made it possible for the modern global supply chain to evolve.

Outsourcing to low-wage countries became a viable alternative, and the result was a revolution in the way products are manufactured and sourced. But the revolution was given a big assist by fuel prices that fell steadily in real (i.e., inflation-adjusted) terms since the mid-1980s.

Falling real fuel prices also made possible the other big story in ocean transport: increasing speed. Today's fast container ships use twice as much fuel per unit of freight as did the ships of 20 years ago.

Things are different now. Oil prices have been trending upward since 2002, thanks to stagnant supply and rising demand from emerging economies, especially the so-called BRIC countries of Brazil, Russia, India, and China. The price of oil rose roughly 90 percent in the last year alone, and it appears that market expectations have finally caught up to economic realities. Few now believe that high fuel prices are a short-run phenomenon.

Not surprisingly, this has changed the equation of shipping containers from China, because transport costs over such long distances closely track oil prices. A new study by CIBC World Markets finds that the average cost of shipping a standard 40-foot container from China to North America has nearly tripled since 2000. Every dollar increase in the price of oil adds a de facto tariff that makes imports less attractive.

Just as drivers are only starting to adjust to higher gasoline prices, shippers are starting to alter supply chains. The Wall Street Journal recently reported anecdotal evidence that some manufacturing jobs are returning to the U.S. and Mexico due to higher fuel prices.

The CIBC study finds that Chinese imports of products (like furniture) with low value-to-weight ratios (for which shipping costs make up a large proportion of total costs) are already declining. And a recent Furniture Today article noted that fewer American buyers are attending Chinese furniture shows.

Rising wages

China's rock-solid advantage since the start of its push for export-led economic growth has been its low wage rates, fueled by an apparently endless stream of rural laborers migrating to the country's port cities to work in the massive factories. But even China is finding that human capital is not inexhaustible, in part because of the country's restrictive "one child" policy and in part because broader economic growth is creating other opportunities for talented workers.

Chinese manufacturing wages have risen by double-digit percentages since 2002, much faster than in the 1990s, and even faster than the economy as a whole has been growing.

Chinese wages have to be much lower than U.S. wages for outsourcing to work, due to elevated costs of quality control, managerial oversight, and of course transportation. Consequently, while wages are still low in China, there is growing pressure on manufacturers to find even lower wages, whether in China's interior or in other countries.

Weak dollar

For years, China pegged the value of its currency, the renminbi, to the dollar. Strictly speaking, China didn't "manipulate" its currency as was frequently claimed by U.S. politicians and business lobbyists, but it certainly made the renminbi cheap in order to encourage imports into the U.S. In 2005, China changed its currency policy, and since then the renminbi has risen about 16 percent against the dollar.

At the same time, due to a variety of other factors, only some of which are related to our curious economic policies in the U.S., the dollar has weakened dramatically against most major currencies, including a nearly 40 percent drop against the euro since 2000.

The dollar's overall decline has hurt Chinese revenues in many industries, and it's connected to a number of rising material prices that Chinese manufacturers must pay (especially including oil, which is traded internationally in dollars).

There are other factors, including rising food and metal prices, that are also pushing up the prices that Americans pay for products made in China. Each one results from long-term structural causes, and yet they've become obvious only in the last few years. We're experiencing a kind of "perfect storm" of inflationary effects.

Will high fuel prices, rising wages in China, the weak dollar, and rising commodity prices cause American manufacturing suddenly to spring phoenix-like from the ashes of the past 20 years? It's unlikely. In many industries, these developments are likely to increase manufacturing activity in Mexico and Central America more than in the U.S. But with capacity utilization at relatively low levels in the U.S. (currently 73 percent in furniture manufacturing, down from 85 percent in the late 1990s), there's room here to absorb some increased production.

The bottom line is that for a wide variety of products, the China Price is rising. Unfortunately, the factors pushing up the China Price are also, to some degree, raising the "America Price."

Author's Note: In my May column, I calculated ratios of imports to domestic consumption to gauge the extent of import penetration in various product categories, including furniture. Because the statistics I used were valued at wholesale rather than retail, my ratios understated the rate of import penetration as usually calculated. However, my main point remains: imports have penetrated many other industries much more than in furniture. Thanks to Jerry Epperson of Mann, Armistead & Epperson for alerting me to this.